

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

Ex Parte No. 582

PUBLIC VIEWS ON MAJOR RAIL CONSOLIDATIONS

COMMENTS OF THE

NORTH DAKOTA PUBLIC SERVICE COMMISSION

NORTH DAKOTA GRAIN DEALERS ASSOCIATION

NORTH DAKOTA WHEAT COMMISSION

NORTH DAKOTA BARLEY COUNCIL

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Introduction

The tendency of large railroads to concentrate their traffic on a series of high density megaroutes is dictating which grain shippers will survive and where they must locate. This is not a proper function of railroads, yet it is a role that will be continued and accentuated through additional mergers. This trend is contrary to the public interest.

Since the Staggers Rail Act was enacted nearly twenty years ago, the number of major railroads in this country has declined from over forty to only four. Rail shippers have far fewer options than they did in 1980 and, in many instances, they have helped finance huge premiums that were paid when railroads entered into bidding wars to acquire their competitors.

We are now approaching the end game – the final mergers of Class I carriers are in sight. It appears that we may well end up with only two major railroads to serve the United States and Canada.

We fear that this eventuality will pose severe problems for agricultural shippers in rural areas. It is extremely frustrating when farmers and grain elevator managers must compete in an environment that is dictated more by

national and international politics and decisions made in distant corporate board rooms than by their own efficiencies.

The well being of farmers in Great Plains states dictates that further mega-mergers be reviewed far more closely than prior mergers. Congress, the rail industry, and shippers must come to grips with where we are and chart a course that will insure that adequate service and competitive rates are a reality rather than theoretical arguments.

North Dakota Parties

This statement is submitted jointly by the North Dakota Public Service Commission, the North Dakota Grain Dealers Association, and North Dakota Wheat Commission, and the North Dakota Barley Council (North Dakota). These parties are identified in detail at the end of this statement.

North Dakota believes that the Surface Transportation Board is taking the correct approach by initiating this proceeding and by looking at the “down stream” impacts of further mergers in the rail industry. This macro-perspective is appropriate for several reasons:

- ◆ There has been a lack of Congressional action to acknowledge structural, merger-related changes that have occurred in the rail industry since the passage of the Staggers Act in 1980. It is no longer necessary to merge railroads to strengthen a struggling rail industry.
- ◆ It may be time to “let the dust settle” before more mergers are approved.
- ◆ Larger railroads usually do not pursue the business of small shippers as aggressively as smaller railroads.
- ◆ Multi-national carriers could amplify problems associated with international trade agreements.

Changed Environment – Lack of Corresponding Oversight

The Staggers Rail Act and subsequent actions by the Interstate Commerce Commission reduced regulatory oversight of the rail industry. These actions were predicated on the belief that competitive forces, rather than

government intervention, were capable of controlling the pricing and service of major railroads.

Since the Staggers Act was passed nearly 20 years ago, the amount of intramodal competition within the rail industry has declined dramatically. In the mean time, the rail industry's lobbying power has increased.

These changes have rendered the competitive precepts of the Staggers Act nearly worthless for many shippers of bulk commodities such as grain. The STB has acknowledged these changes and has initiated proceedings to interject more competition into the rail industry. The rail industry, however, has fought and still is fighting these proposals before the Board and courts.

The STB has stated that Congressional action is required to make certain pro-competitive changes in existing regulatory policy. The rail industry has fought these proposals, too. The rail industry obviously has a good thing going and it does not want to give it up.

The STB should resist further merger proposals until the rail industry concedes to the enactment of pro-competitive changes by both the STB and Congress. Pandora's Box is sitting at the STB. Opening the box now will eliminate the chance of leveraging the railroads' desire for more mergers into support for fundamental changes in rail regulation that will provide long term benefits to the shipping community and the Nation's economy.

Let The Dust Settle

There have been several major rail mergers in recent years. The STB is well aware of the operational difficulties that newly-merged companies have encountered and of the disruptions that these mergers have caused for the shipping community. Many shippers are still trying to recover from the pain caused by these mergers. These shippers may need time to heal before they are forced to swallow another merger pill.

It also seems that mergers are often the railroads' easiest target in their quest for increased efficiencies. "Single line moves" and "marketing" are repeatedly cited by the rail industry as justification for mergers. Mergers and

consolidations are not, however, the only ways that railroads can improve interline service and marketing. Perhaps rail carriers should be looking for more ways to work together rather than simply buying up the competition.

It also appears that the rail industry may perceive the existing statutory environment as a narrowing window of regulatory opportunity and that carriers are rushing to complete major mergers before policy makers and the public recognize what is happening. Once mergers are complete, it will be extremely difficult to undo them.

Maybe it is time to stop and reflect on where we are and where we are going. What we do today will dictate our future. These are major steps. They should be well thought out, not only for the benefit of railroad stockholders, but also for the benefit of shippers and the consuming public.

Smaller Is Often Better

In the past 15 years, nearly one-third of North Dakota's 4,000 mile rail network has been sold or leased to short line operators. This occurrence has not been unique to our state – it has been repeated over and over across the country.

Short line operations are not immune to abandonments. In fact, short line companies operated nearly all of the 165 miles of North Dakota track that was abandoned in 1999.

Despite this fact, it is safe to say that virtually all the North Dakota shippers and communities that are served by short line operators have noticed improved service and marketing efforts since their lines were transferred away from Class I operators.

Unfortunately, the opposite is also true. Extremely large carriers often focus on high volume shippers and increased efficiencies related to larger shipment sizes and shorter loading times. In the grain industry, many of these efficiency gains are the result of shipper investments, but most of the resulting benefits go to the railroads.

These changes are also accelerating consolidations within the grain industry. Some Class I carriers are overly focused on larger shippers; they do not aggressively pursue marketing opportunities related to small shippers. Many small operators are being disadvantaged or forced out of business; often for reasons related to railroad car ordering programs, shipment size requirements, and reduced loading time limits.

It is also important to note that many of the volume-related initiatives that are being promoted by major carriers are, in fact, contrary to trends that are taking place in agriculture. Many farmers and grain elevators are concentrating on niche markets (i.e. the production of high quality spring wheat for use in bagel production). These markets do not want and cannot take trainloads of grain; they want a few cars at a time. Large carriers seem reluctant to cultivate and promote these markets, thereby depriving farmers and elevators of related opportunities.

This nation's economy is largely dependent on the growth of small businesses. In North Dakota, it does not seem that big railroads are willing to play a part in this economic development trend. Big railroads like big shippers and design their price and service offerings accordingly. As carriers get larger and larger, more and more pressure is placed on shippers to either expand and upgrade or perish. More mega-mergers should be delayed until carriers demonstrate a corporate willingness, desire, and ability to respond to the needs of all of their shippers, regardless of size.

Cross Border Complications

Single line movements facilitate traffic flows and management decisions dictate which markets a railroad will compete in. Further mergers will, in all likelihood, cross international boundaries and may worsen existing problems involving trade agreements and the inequitable treatment of farmers in one country versus another.

Grain flows from Canada to the United States have increased dramatically since the enactment of the North American Free Trade Agreement (NAFTA).

This occurrence is not solely the result of the lessening of barriers related to cross-border shipments. It is also a function of transportation.

A situation currently exists in northwestern North Dakota where it costs 18 cents per bushel more to ship grain by rail to Minneapolis than it does from a similarly situated station just a few miles away on the Canadian side of the border. The lower Canadian rate exists either because of political pressure imposed by the Canadian Wheat Board on Canadian railroads or because of statutory rate caps that encourage Canadian railroads to promote shipments to U.S. markets rather than to their own domestic markets.

The fact that Canada uses a different grain grading system than the U.S. makes it impractical for North Dakota farmers to deliver their grain to the Canadian point and to, thereby, take advantage of the lower rate. Therefore, the rate differential gives Canadian grain an insurmountable advantage in the Minneapolis market. U.S. grain is, therefore, displaced by Canadian grain.

The same Canadian-based carrier serves both the Canadian and the North Dakota origins. It has chosen not to make the same rate available for both. Similarly, the other U.S. Class I carrier that serves the area has chosen not to match the Canadian rate.

These corporate decisions by both carriers are having an enormous impact on farmers and grain elevators across the entire region and are contributing to the imbalance in trade between the two countries. There is five times as much Canadian grain moving into the United States as there is US grain moving into Canada. It is not in the best interest of United States farmers to disproportionately promote the fortunes of their Canadian counterparts.

North Dakota producers are willing to compete on a level playing field, but unfair advantages that result from corporate action or inaction is totally unacceptable. It does, in fact, jeopardize farmers' livelihood and the well being of many rural communities. This type of behavior from monopoly and oligopoly carriers is intolerable; the STB should deny further merger applications until appropriate safeguards are in place. These safeguards should include either 1)

fair, effective, simple, and affordable ways for shippers to challenge rates or 2) mandatory competition at all shipping points.

As we move further into a system where carrier operations straddle international boundaries, it is also important that we fully understand how these mammoth carriers are going to be regulated. Is there sufficient regulatory muscle on either side of the border to regulate carrier activities for the common good of shippers in both countries? In the pricing situation cited earlier, if all rates in question were below prescribed maximums (i.e. 180 of variable costs in the US and 140 percent of variable costs in Canada), what actions could be taken if one country's shippers still paid substantially higher rates than a nearby, cross border, competitor?

For example, if a U.S. carrier unreasonably favors one shipper over another similarly situated shipper, the aggrieved shipper may seek a remedy under Section 10741. However, if the U.S. – Canadian border separates these two shippers, jurisdiction becomes an issue. Cross-border mergers will increase opportunities for cross-border rate discrimination; these inequities may be jurisdictionally unremediable.

Sorting through this situation must be a deliberative process. It should be done before the fact, not after.

Conclusion

Over the past twenty years the rail industry has shown a propensity to seek efficiency and profitability through mergers. These mergers have reduced the intramodal competition that the Staggers Act was dependent on to control carriers' pricing and service practices. It may be appropriate to curtail further merger activities until Congress and the STB can analyze the "down stream" impacts of further consolidation. Safeguards must be put in place to insure that shippers of all sizes will not experience a further deterioration of service and even higher rates.

North Dakota Parties

North Dakota Grain Dealers Association - The North Dakota Grain Dealers Association (NDGDA) is an 89 year-old voluntary membership, nonpolitical trade association of grain elevators in North Dakota. More than 90% of the state's 450 grain elevators are members of NDGDA.

Country grain elevators are the first point of sale for most crops grown by North Dakota farmers. These elevators clean and blend grain and ship it to both domestic processors and export ports. These destinations are generally located between 300 and 1500 miles from North Dakota and, given the state's lack of navigable waterways, are accessible only by rail.

Approximately 90 percent of North Dakota's grain elevators have rail service; less than 3 percent have direct access to more than one carrier. Elevators with rail service handle about 95 percent of the grain marketed annually by local farmers. Approximately 70 percent of all the grain sold by grain elevators each year is moved to market by rail.

North Dakota is served by two Class I railroads. Burlington Northern Sante Fe and its short line affiliate, the Red River Valley and Western, serve about 75 percent of the elevators that have rail service. The other 25 percent are served by the Canadian Pacific Railway or its short line affiliates, the Dakota, Missouri Valley and Western or Northern Plains Railroad.

Transportation is vitally important to grain elevator operators. Without adequate and reasonably priced transportation services, elevators cannot sell and deliver their grain to distant buyers. These firms must cover their operating costs and earn a profit from a margin that equals as little as 2% of the cost of the commodity that they are handling. There is, quite simply, little room for error. Effective competition or meaningful regulatory oversight are essential to North Dakota's grain elevator industry and to the farmers that it serves.

Wheat Commission & Barley Council - The North Dakota Wheat Commission and the North Dakota Barley Council were created by the state legislature and exist to promote the use of wheat (flour), durum (pasta), and barley (malt for beer and grain for human and animal consumption) that is grown in the state. These Commissions are financed through voluntary per bushel payments that are made by North Dakota's 30,000 farmers when they sell the grain that they produce each year.

Transportation is vital to farmers. If elevators cannot sell and deliver grain to distant markets, there ceases to be a local market for farmers' grain. North Dakota's physical location makes it impractical for these farmers to deliver their grain to distant terminal locations such as Minneapolis. They depend on local grain elevators to provide this crucial marketing link. If elevators are unable to provide a local market for farmers' grain, farmers are left with no viable alternatives.

Farmers indirectly pay to have grain sent from their local elevator to distant terminal markets. The costs that grain elevators incur when delivering grain to terminal markets directly impacts the prices that elevators are willing and able to pay farmers for their grain. High freight rates mean lower grain prices and lower farmer income. These factors also have a direct impact on the value of the land that farmers own since land values are directly related to the net income that farmers are able to realize from that asset.

Agriculture is North Dakota's number one business. Over fifty percent of the state's economy is dependent on agriculture. Without the ability to move its agricultural production to distant markets at reasonable and competitive rates, North Dakota's vast production capabilities lose all or part of their value. This proceeding is extremely important to North Dakota, its grain elevator industry, its economy, and individual farmers throughout the state.

North Dakota Public Service Commission - NDPSC is a three-member constitutional body that is charged with representing North Dakota's shipping interests in proceedings such as this. NDPSC has been active in Interstate Commerce Commission and Surface Transportation Board cases for well over

one hundred years. This level of involvement is indicative of the state's need for reliable, reasonably priced transportation services and its lack of transportation alternatives.

Jon H. Mielke, Executive Secretary
North Dakota Public
Service Commission

2/25/00

Date